Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Unbundled Access to Network Elements	)	WC Docket No. 04-313
	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)))	CC Docket No. 01-338

COMMENTS OF
DIALOG TELECOMMUNICATIONS, INC.

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SUMMARY

To preserve competition for rural phone service, it is imperative that the Commission preserve access to unbundled switching for residential customers. Unlike urban and business customers, residential rural markets are characterized by poor economies of scale and scope, as well as income constrained customers, making it more difficult for a facilities-based competitor to justify the investment in the residential market as compared to a competitor serving business customers or operating in an urban market. Through investigation and experience, Dialog has found that there are no practical competitive alternatives to residential UNE-P in rural areas in which competition is yet to fully develop.

Absence of UNE-P will be detrimental to the public interest, because lack of competition in this market will result in higher rates and fewer services for the vast majority of telecommunications customers. Moreover, the barriers to entry are higher to competitors in rural markets. Without UNE-P, competition cannot be established or preserved in rural markets.

The Commission should also be aware of, and embrace the intent of, the Regulatory Flexibility Act. The RFA requires the Commission to examine the public policy issues using an analytical process that identifies, among other things, barriers to small business competitiveness and the impact of a rule change on the economic viability of affected small business. A small business cannot raise capital given the uncertain regulatory environment created by the Commission and the *USTA II* court and this condition will persist until permanent rules are in place and the possibility of further challenges in the courts has subsided.

The mandate from the *USTA II* court does not require the Commission to eliminate UNE-P; rather, the Commission is directed to provide more support for its original impairment determination. Ample evidence exists regarding hot cut performance, access to customer

information, and overall entry barriers to support continued unbundling of switching for residential customers, particularly in rural markets. Dialog proposes that the Commission adopt an impairment standard that uses a line-density analysis, applied on an end office basis, that will establish the threshold at which competitive carriers are no longer impaired without access to unbundled switching for residential customers. This is an easily administered standard that recognizes practical investment concerns and conforms to the Commission's current impairment considerations, especially in regard to economies of scale, sunk costs, and first mover advantages.

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Dialog Telecommunications, Inc. ("Dialog") is a privately owned small business, with 15 employees and 10,000 customers, that has focused on providing local phone service to residential customers in rural markets in Kentucky. Dialog currently leases approximately 10,000 lines serving mostly low to middle income households, many consisting of retirees on a fixed income. Dialog's basic local and long distance bundle (which more than 80% of its customers purchase) is offered at a fixed price of $35 per month, including all taxes, fees and surcharges.

Dialog began offering service in January 2002 with a business model that, rather than duplicating the products and approaches of the incumbent (BellSouth), modifies product offerings, billing, sales methods and customer service in ways that greatly reduce its operating and acquisition costs while delivering excellent value to our customers. Dialog is profitable and has been cash-flow positive for more than 2 years. Customer satisfaction is particularly high, with more than 70% of its new customers coming as referrals by existing customers. While the majority of Dialog's customers are conversions from the incumbent, approximately 10% are for new lines, purportedly because BellSouth's deposit requirements are an obstacle to obtaining service.

Provided that the regulatory climate supports access to financing, Dialog would like to move aggressively to build its own switching facilities and network to meet customer demand for both higher quality service and additional products including broadband access. It understands that, with closer control of its network, it can better meet its customers' needs, improve gross margin, and be more competitive. As explained below, however, even with access to financing, Dialog does not yet have adequate customer density to enable network deployment. This is why unbundled switching for residential customers, and UNE-P, are critical to development of competitive alternatives for customers in rural Kentucky.

I. COMPETITION IS STILL UNDEVELOPED IN RURAL, LOW DENSITY MARKETS

For all intents and purposes, there are no competitive alternatives for residential customers in small markets. Smaller rural markets are characterized by lower household incomes, lower density and slower technology adoption than urban markets. Therefore, some of the competitive alternatives that are attractive in urban markets are simply unaffordable or unavailable in small markets. In these markets, the only competitors offering a landline based service to small business and residential consumers are using UNE-P to do so. In the markets that Dialog serves, it was the first competitor for these customers when it entered those markets almost three years ago. Before UNE-P, there was no residential competition other than high-priced prepaid service for the "credit challenged." In small markets, UNE-P is the enabler for a competitive telephone company to get to the scale required to operate a facilities-based network.

While there have been arguments made both for and against the consideration of intermodal competition, the reality of the consumer market is that these opportunities only exist for the wealthiest consumers. Any consideration of the viability of intermodal competition must give consideration to the minimum "entry" price for a service. VoIP and cellular cannot be considered "competition" for low income or fixed income consumers, including large numbers of elderly consumers.

In most of these rural markets, cable companies are not providing VoIP or other phone service. Many of Dialog's markets are served by non-MSOs without the quality of plant or business resources to offer VoIP. Even those with two-way capable plant do not offer, and have not announced, a plan to offer VoIP. As with the incumbent telephone company, small markets do not seem to be a priority for the cable companies. Were it to be offered, it would likely be uneconomic for many consumers since all cable companies that offer VoIP today require the customer to purchase broadband internet access or digital television services in addition to VoIP. VoIP bundles today are more than $75 per month plus taxes and fees.[1]

The principal cellular carriers are owned by the incumbent telephone companies. In Dialog's markets, Verizon and Cingular are the primary cellular carriers. Cellular coverage is relatively poor in Dialog's rural markets. Furthermore, for the average consumer in those markets, cellular is not economical: while Verizon offers a $24.99 plan and Cingular offers a $29.95 plan in these markets, there are significant fees and taxes added to these "advertised"

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[1] *See* Market Survey, attached hereto as Exhibit 1 (demonstrating that cable broadband costs about $50 per month. While VoIP is not offered by the carriers in Dialog's markets, a customer could buy VoIP (without 911 and without a local number) from Vonage for $25 per month.

prices, and customers must pay $0.45 per minute for usage in excess of 100 or 250 minutes per month respectively.

II. RESIDENTIAL CLECS FACE GREATER BARRIERS TO ENTRY

As a competitor serving primarily residential customers, Dialog is at a distinct disadvantage. Most network-based competitors are targeting the most profitable customers in the largest markets. Building a business, winning customers and building a network to serve residential customers in small markets has taken much more time, and this process began much later in the more rural markets. As the attached survey demonstrates,[2] competition is only beginning to gain traction, so a finding of no impairment of switching for residential customers will ensure that consumers in smaller communities will not benefit from choices, savings and innovation like customers in larger markets. Premature elimination of UNE-P will eliminate any competitive alternative.

For a number of reasons, residential customers produce much lower margin than business customers. First, BellSouth's rate for UNE-P is higher than the retail price for the basic local product in rural markets, placing Dialog in a price squeeze that reduces margins. Second, residential-focused companies do not benefit from the cross-subsidy inherent in the pricing of business services. Third, Dialog cannot supplement its local service offerings with high margin advanced services, like DSL, because BellSouth restricts CLEC access to this service and most of Dialog's customers are content with dial-up internet access.

Finally, the incumbent's first mover monopoly advantage, which provides contact and usage information for every customer, enables the incumbent to target its marketing much more

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[2] *Id.*

effectively both for the sales of new products like broadband and long distance, not to mention its win-back offers. It also costs the incumbent little or nothing to contact those customers with new offers through their monthly bills.

CLECs serving residential customers in small markets need time to achieve the density required to profitably operate a facilities-based network. As the Commission has already noted, even ILECs will agree that "competitive carriers suffer cost disadvantages and other barriers when they self-deploy switching in some locations."[3] The BellSouth central offices serving Dialog's customers are typically small, and this tends to increase the amount of time required for Dialog (or any other CLEC) to achieve the scale economies necessary to serve these customers profitably using their own switching and ILEC loops accessed through collocation. Obviously, reaching reasonable scale in a central office with 100,000 lines should happen much faster than in a central office with 10,000 lines, since most of the cost of collocation is fixed and only a certain percentage of the market is amenable to switching at any given time. Dialog would need at least 2,000 lines per central office to achieve breakeven using its own switch, together with ILEC loops that are accessed through collocations. It is unrealistic to expect a CLEC in a rural area to sign up 2,000 customers in a central office in a short time, and thus UNE-P is needed for a CLEC to assemble a large enough customer base to make conversion to a UNE-L strategy feasible.

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[3] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 para. 529 (2003), *corrected by* Errata, 18 FCC Rcd 19020 (2003)(*Triennial Review Order*).

III. THE COMMISSION SHOULD CONSIDER THE MANDATES OF THE REGULATORY FLEXIBILITY ACT IN ESTABLISHING RULES AFFECTING CLECS THAT ARE SMALL BUSINESSES

The Commission's UNE rules in place since 1996 have encouraged small business investment to attain the Act's objective of stimulating competition in the telecommunications sector. Competition has, however, been impaired from a small business perspective by the recent actions of the Commission and the *USTA II*[4] court. As a consequence of recent rules and decisions that portend the elimination of unbundled switching, and create great uncertainty around the availability of other elements, including loops, Dialog's investors are unwilling to invest in a network given the continuing ambiguity of the regulatory environment, notwithstanding that Dialog has operated profitably for more than two years and has a tremendous opportunity for growth.

Dialog contends that similarly-situated small businesses in other industries could raise the capital for the scope of the expansion that Dialog plans. Absent the pessimism fostered by the Commission and the *USTA II* court, Dialog could do the same. However, the current regulatory situation makes that impossible. To ameliorate this harm, the Commission should embrace the intent of the Regulatory Flexibility Act ("RFA").[5] While the RFA does not seek preferential treatment for small businesses, it does require the Commission to examine the public policy issues using an analytical process that identifies, among other things, barriers to small business competitiveness and the impact of a rule change on the economic viability of affected small

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[4] United States Telecom Association v. F.C.C., 359 F.3d 554 (2004)(*USTA II*).

[5] "[T]he failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity" Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164, Congressional Findings and Declaration of Purpose.

business.[6] The RFA seeks a level playing field for small entities, not an unfair advantage. When the proposed regulation will impose a significant economic impact on a substantial number of small entities, the agency must evaluate alternatives that would accomplish the objectives of the rule (in this case, to foster competition in a legally sustainable fashion) without unduly burdening small entities. Therefore, Dialog believes the Commission must not only be urged to consider the impacts of its policy changes on small business, but is legally obligated to do so.

IV. THE COMMISSION HAS AMPLE CAUSE TO CONTINUE TO UNBUNDLE SWITCHING FOR RESIDENTIAL CUSTOMERS

While *USTA II's* vacatur of the mass market switching rules may have appealed to the inclinations of the BOCs, it cannot be emphasized more strongly that *USTA II* did not find unbundled switching to be inherently unlawful or antithetical to the goals of the Act. *USTA II* merely disapproved of the Commission's overly broad "non-provisional national impairment finding"[7] and the sub-delegation of local non-impairment determinations.

Indeed, the court threw out a few lifelines to preserve unbundled switching. For example, it suggested that impairment determinations could be based on the ILEC's track record for speed and volume in a market, integrated with some projection of the demand increase that would result from withholding of switches as UNEs.[8] It also accepted the ILECs' own

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[6] "Each initial regulatory flexibility analysis shall also contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities." 5 USC 603(c).

[7] USTA *II*, 359 F.3d at 570.

[8] *Id.*

suggestion that the Commission consider "rolling" hot cuts as another option.[9] Most importantly, the *USTA II* court preserved the Commission's impairment standard, albeit offering some "suggestions" for improvement.

A. Hot Cuts Continue To Factor In Impairment Analysis for Residential Customers

The Commission's findings in regard to mass market switching are globally correct, and when applied to residential customers in small markets, the impairment is even more obvious. Even though the *USTA II* court complained of an apparent inconsistency in the Commission's findings that hot cut procedures were sufficient for Section 271 approval but not sufficient for a finding of non-impairment,[10] the Commission must not retreat from this justification. Any finding of non impairment must be conditioned on *continuing* performance of hot cuts at a reasonable rate in a commercially reasonable amount of time and a commercially acceptable manner for the *particular market* in question. This is especially important in low-density rural markets because of the distances between offices and the relatively higher cost per customer of network technicians. In addition, while the non-recurring costs are spread across many lines in the typical cutover of a business account, the competitor serving the residential customer must apply all of the non-recurring costs to a single line.

The *USTA II* court suggested that rolling hot cuts would eliminate this disadvantage. In a large market with significant density, this approach might reduce the costs and delays associated with converting the customer to the new carrier. However, this approach does not address the cost concern for the residential customer, and additionally creates the new problem of putting the

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[9] *Id.*

[10] *Id.*.

customer through multiple conversions which often result in service affecting problems. As customers are affected by these service problems they invariably blame the competitor, to the incumbent's advantage.

The negative impact of multiple conversions can not be overstated. Take the common example of converting a customer with voicemail. Upon conversion to UNE-P the customer's messages and account information are deleted, forcing the customer to go through the setup process again. Upon conversion then to facilities, the customer's messages and account information are again deleted.

B. Customer Transition Is Hampered By Inadequate Access To Customer Information

It is also important to recognize that competitors are significantly impaired by limitations the incumbents have placed on access to customer information. For example, CLECs are unable to see if an incumbent's customer has a local service freeze on their account. An attempt to convert such a customer in a UNE-P environment results in the order being rejected the following day, and causes conversion delays. These conversion delays negatively impact CLEC customers by causing them to continue to be billed at the higher incumbent carrier billing rates and by causing confusion about what services they do have. This process negatively impacts the CLEC because their new customer is inconvenienced, additional effort must be expended to resolve the rejected order, and revenue is lost. In a facilities environment, the impact of having inadequate access to customer information can be further exacerbated by the technical complexities of coordinating cutovers with the ILEC and national number porting database providers, resulting in further lost CLEC revenue, and continued ILEC billing to the end user customer.

V. UNIVERSAL SERVICE ISSUES CANNOT BE ADDRESSED BY ELIMINATING UNBUNDLED RESIDENTIAL SWITCHING

The USTA II court expressed concern that the Commission did not account for the societal costs that might be incurred if TELRIC rates were so low as to promote competitive rates that would undermine the business-to-residential cross subsidies inherent to universal service.[11] The court's concern has a certain validity, but is too narrow. Unless the court is suggesting that this is a justification for preventing all competition, it is inevitable that incumbents are going to have to modify their business plans to continue to meet their universal service obligations if they lose the business customers that currently subsidize these obligations . Whether these accounts are lost to a facilities-based or UNE-P carriers, however, is largely irrelevant.

What is relevant is that the incumbents were certainly aware of this challenge, and must have determined that they could generate enough revenue from new products and bundles to offset the impact of UNE-P based competition when they agreed to this type of competition to obtain approval of their 271 filings. In other words, the burden of unbundling cannot be analyzed in isolation. Unbundling, at cost-based rates, is, in a sense, the ILEC consideration provided in exchange for entry into in-region long distance, which has been eminently successful for the ILECs. If lower than desired margins are realized on unbundled elements, this should be weighed against the revenues provided by long distance services and advanced services. It must be assumed that the BOCs were fully comfortable with that result, but never ceased to challenge the unbundling rules and now are leaping at the opportunity created by the *USTA II* court to increase their margins even further.

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[11] *USTA II*, 339 F.3d at 573.

VI. TO ENSURE THE BENEFITS OF COMPETITION TO RESIDENTIAL CUSTOMERS, THE COMMISSION SHOULD ADOPT A LINE DENSITY THRESHOLD TRANSITION MECHANISM

As if the Commission actually needed to be reminded, it has been directed by *USTA II* to review the mandate of *USTA I* that "the Commission may not 'loftily abstract[ ] away from all specific markets,' but must instead implement a 'more nuanced concept of impairment.'"[12] In the interest of developing a more "nuanced concept of impairment," these Comments seek to persuade the Commission that, in Dialog's experience, there are indeed markets in which requesting carriers are impaired, at least for a certain duration of time, without access to unbundled elements. For that reason, Dialog proposes the following:

First, the Commission should find that requesting carriers are impaired without access to unbundled switching provided to residential customers in central offices with fewer than 25,000 residential DS0s where fewer than 8,000 residential DS0s are served by all competitors. As opposed to transition plans implemented over an arbitrary period of time, a density-based plan best addresses at least three of the key factors that the Commission favors in gauging entry barriers:

- Scale Economies: It goes without saying that line density is the epitome of the type of indicator used to measure economies of scale.
- Sunk Costs: Once the threshold is reached, the new entrant is in a position to generate the cash flow necessary for debt service on large capital investments (particularly the cost of a switches and collocation arrangements), or to attract investment capital for the

[12] *USTA II*, 359 F.3d at 569 (citations omitted).

same purpose. Moreover, with sufficient line density, a new entrant is better insulated from the vagaries of customer turnover, making it safer to incur large sunk costs.

- First Mover Advantages: At the suggested threshold, a new entrant is no longer an unknown in the market place, and at that point has the market exposure and depth to counteract more of the first mover advantages of the incumbent.

Moreover, the Commission, while not adopting similar density-based plans, has indicated a familiarity with the concept and did give credence to these plans in its overall reasoning.[13]

Second, once this threshold is reached and assuming that it is maintained, there will be a 24 month transition to market-based rates, allowing adequate time for competitors to deploy networks. If competitor lines fall below the 8,000 line threshold within 18 months of a finding of no impairment, the impairment finding would be reinstated.

Finally, for CLECs that are small businesses, as defined by the Small Business Administration, UNE-P would be available for three years after the effective date of the new unbundling rules, regardless of the CLEC's line density on switches on which it leases capacity today. Since customer turnover is a reality in all communications businesses, and a small business must have stable or growing cash flows in order to raise financing, this transition period should be effective for current and new customers. This will provide adequate time for a CLEC with a solid business plan to convince investors that the current regulatory uncertainty has been resolved, to build a network, and to transition customers to that network. Moreover, because it relies on qualifications administered by the SBA, it would be administratively simple for the regulatory body charged with oversight, be it the Commission or a state commission.

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[13] *Triennial Review Order* para. 530.

VII. CONCLUSION

Accordingly, the Commission should adopt the transitional mechanism described herein.

Respectfully submitted,

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EXHIBIT 1

Market Survey

	Source >>			HAI Model Release FCC - Expense Module		Carrier Website or via call to cust srvc			2000 Census			Primary Research	Carrier Website	Primary Research	Primary Research	Primary Research
KY County	Served CLLIs	City Name	Dialog lines	Total residential lines	Cable Company	Cable VoIP available	Cable broadband available	Housing Units	Median HH Income	County Population	County Population Density per sq mile	Dominant Wireless Carrier	Lowest Advertised Cellular Price	Network Based Residential Competitors	UNE-P based Residential Competitors	DSL availability w/o voice srvc
McCracken	PDCHKYMA	PADUCAH	2295	15813	Comcast	No	$45.95 incl modem	30361	33865	65514	261	Verizon	$24.99 +++ (b)	No	Yes	No
McCracken	PDCHKYLO	PADUCAH	1745	7881	Comcast	No	$45.95 incl modem	30361	33865	65514	261	Verizon	$24.99 +++ (b)	No	Yes	No
McCracken	PDCHKYRL	SYMSONIA	1423	5135	Comcast	No	$45.95 incl modem	30361	33865	65514	261	Verizon	$24.99 +++ (b)	No	Yes	No
Graves	MYFDKYMA	MAYFIELD	1296	6898	Charter Comm.	No	$44.99 for 384kb, $54.99 for 3mb incl modem	16340	30874	37028	66.6	Verizon	$24.99 +++ (b)	No	Yes	No
Pike	PKVLKYMA	PIKEVILLE	783	8344	Cebridge	No	No	30923	23930	68736	87.3	Cingular	$29.95 +++ (a)	No	Yes	No
Calloway	MRRYKYMA	MURRAY	555	9641	Charter Comm.	No	$44.99 for 384kb, $54.99 for 3mb incl modem	16069	30134	34177	88.5	Verizon	$24.99 +++ (b)	Yes	Yes	No
Muhlenberg	CNCYKYMA	CENTRAL CY	433	3425	Comcast	No	No	13675	28566	31839	67.1	Cingular	$29.95 +++ (a)	No	Yes	No
Hopkins	MDVIKYMA	MADISONVL	423	10661	Charter Comm.	No	$44.99 for 384kb, $54.99 for 3mb incl modem	20668	30868	46519	84.5	Verizon	$24.99 +++ (b)	No	Yes	No
McCracken	PDCHKYIP	PADUCAH	124	546	Comcast	No	$45.95 incl modem	30361	33865	65514	261	Verizon	$24.99 +++ (b)	No	Yes	No

(a) - Cingular pricing detail - $29.95 + taxes and fees, $0.45 per min after 250 minutes
(b) - Verizon pricing Detail - 24.99 + taxes and fees, $0.45 per min after 100 minutes